

STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS (Continued)
FISCAL YEAR ENDED SEPTEMBER 30, 2000

NOTE 3 – BUDGETING AND BUDGETARY CONTROL

A. Major Constitutional and Statutory Provisions

Balanced Budget Requirements

Article 5 of the State Constitution mandates that the executive budget recommend spending limits for operating funds to the Legislature that are within available resources. Compliance with this is demonstrated in the executive budget and budget bills for each fiscal year.

Article 4 of the State Constitution mandates the Legislature to enact appropriations for each operating fund that does not exceed that fund's revenue estimates, including beginning unreserved fund balance.

Compliance with this requirement is demonstrated in schedules included in the annual appropriation acts, usually the "General Government" appropriation act. When it appears that revenue will fall below the estimates on which the appropriations are based, the Governor is required to recommend spending reductions as necessary to avoid a year-end deficit.

Local Spending Requirements

Article 9, Section 30 of the State Constitution requires that State spending to, or on behalf of, local units of government shall not fall below a specified percentage of total State spending. The percentage, recalculated effective with fiscal year 1992-93, is 48.97%.

Final calculations establishing the State's compliance with this Constitutional provision for fiscal year 1999-2000 are not yet complete. For fiscal year 1998-99, the most recent year for which final calculations are available, the proportion of total State spending paid to local units of government was determined to be 60.93%, reflecting payments that exceeded

the minimum required by \$ 2.7 billion. The State expects that payments to local units of government will exceed the minimum requirement for fiscal year 1999-2000.

Revenue Limits

Article 9, Section 26, of the State Constitution restricts State revenues to a ceiling that is based upon revenues as a proportion of total personal income for the State. The base year ratio, determined in fiscal year 1978-79, in relation to calendar year 1977 personal income, is 9.49%. Both the constitutional language and implementing statutes provide for other adjustments to the revenue and personal income calculations. If revenues exceed the limit by 1% or more, the amount in excess must be refunded to personal income tax payers and payers of the State's single business tax. If the limit is exceeded by an amount less than 1%, the excess may be deposited into the State's Budget Stabilization Fund. The calculations determining the State's compliance with this Constitutional provision for fiscal year 1999-2000 are not final. The State estimates that total State revenues subject to the limitation will exceed the limit by \$158.2 million for fiscal year 1999-2000, which is less than 1% of the limitation.

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Budget Stabilization Fund

The Counter-Cyclical Budget and Economic Stabilization Fund ("Budget Stabilization Fund") was created by P.A. 76 of 1977 to assist in stabilizing revenue and employment during periods of economic recession. In general, the law requires payments into the fund when real economic growth exceeds 2% and allows withdrawals from the fund when real economic growth is less than 0%. Funds can also be withdrawn when the State's unemployment rate exceeds 8% or upon appropriation to finance capital outlay or other projects, or for other purposes designated by the Legislature.

The following table summarizes the transactions for the fund for fiscal year 1999-2000 (in millions):

Beginning unreserved fund balance	\$ 1,222.5
Interest income	74.0
Transfers from General Fund	100.0
Transfers to School Aid Fund	(32.0)
Transfers to State Trunkline Fund	(100.0)
Ending unreserved fund balance	<u>\$ 1,264.4</u>

Transfers from the General Fund represent the transfer of \$37.1 million pursuant to P.A. 124 of 1999, section 212, and P.A. 431 of 1984, section 352, as amended, and the transfer of \$62.9 million, pursuant to P.A. 506 of 2000, section 203. The transfer to the School Aid Fund is for the purpose of paying money damages to school districts and intermediate school districts as required by P.A. 144 of 1997. The transfer to the State Trunkline Fund is for the purpose of funding a portion of the Build Michigan III program, pursuant to P.A. 189 of 2000, section 358.

B. Budgetary Control - Governmental Fund Types

A number of different budgetary control processes are used for the various funds and programs within funds. Annual legislative appropriations and revenue estimates are provided for most "operating" funds. These annually budgeted operating funds include the General Fund and 24 of the special revenue funds. (Note #2 identifies the annually budgeted operating funds.) The other funds do not have complete legally adopted budgets, but they are usually subject to some more limited form of budgetary control, such as financial plans or a limiting of expenditures to the amount of resources. The budget-to-actual comparative statements in this report reflect only the annually budgeted operating funds of the primary government with legally adopted budgets.

Revenues

General purpose (unrestricted) revenue estimates are provided in both the original executive budget and in original legislative appropriations in order to demonstrate compliance with constitutional provisions. The Department of Treasury is responsible for updating revenue projections. Revenues restricted by law or outside grantors to a specific program are estimated at a level of detail consistent with controlling related expenditure accounts.

Spending

The level and method of control provided over spending varies between funds and programs. Appropriation line items may be by program, organization, project, object, or a mix of these. If a department wishes to transfer spending authority from one appropriated account to another, it must, generally, receive legislative approval. Expansion of total spending authority usually requires a supplemental appropriation. In the event that expenditures exceed authorization during a year, the

department must request a supplemental appropriation (carry-back) for the amount overspent. Supplemental appropriations totaling \$990.2 million were required to support additional spending for capital outlay, school aid funding and various other programs, including grants funded by the Clean Michigan Initiative funds. Unexpended authorization balances lapse at year-end unless carry-forward is authorized by statute or qualifying encumbrance carry-forwards have been recorded.

For programs financed from restricted revenues, spending authorizations are generally contingent upon recognition of the related revenue. If revenues fall short of estimates, related spending authorizations are reduced. If revenues exceed the estimate, supplemental appropriations are required before they can be spent.

Budgetary control of spending is maintained by the central accounting system at the appropriation line item account level. The large number of line items make it infeasible to include a detailed comparison of budget to actual in the State's Comprehensive Annual Financial Report. A separate report is published by the Department of Management and Budget detailing the disposition of authorizations at the line item spending account level, and is available upon request to the Office of Financial Management, Financial Reporting Section.

C. Statutory/Budgetary Presentation

In the Combined Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General and Special Revenue Funds, expenditures, operating transfers out, other financing uses, and encumbrances are combined and classified by department, rather than being reported by character and function as shown in the GAAP statements. This departmental classification is used to better reflect organizational responsibility and to be more consistent with the budgetary process. Generally accepted accounting principles require that the final legal budget be reflected in the "budget" column, therefore updated revenue estimates as of November 30, rather than the amounts shown in the original budget, are reported. The November 30 date is used because P.A. 431 of 1984, as amended, permits budget adjustments by the Legislature through 60 days after year-end.

The expenditures budget column represents original and supplemental appropriations, carry-forwards, carry-backs (i.e., current year appropriations for prior year overdrafts), approved transfers, executive order reductions, and timing differences. The timing differences result from unspent authorizations for multi-year projects, such as capital outlay and work projects, and from restricted revenues which had not yet been appropriated for expenditure in the current year. Such authorization balances remaining at year-end are removed from the budget column to provide an "annualized" budget. "Favorable variances" reflect restricted revenues which were appropriated and available for expenditure in the current year, and unused general purpose spending authority ("lapses"); "unfavorable variances" reflect budgetary overdrafts. If both favorable and unfavorable variances exist for a particular line, the amount shown is the net variance.

Appropriations include interagency expenditure reimbursement, where one agency provides funding to another agency within the same fund. The gross "budget" and "actual" amounts on this statement are adjusted to eliminate the duplication.

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**D. Statutory/Budgetary Reconciliation –
General Fund and Special Revenue Funds**

The statutory/budgetary basis presentation differs from generally accepted accounting principles (GAAP) in ways that do not affect ending fund balance.

Encumbrances

As explained in Note #1, the State records encumbrances at year-end only if they meet certain criteria. For budgetary reporting purposes, the recorded encumbrances are included with expenditures and operating transfers in the "Actual" columns because they are considered uses of spending authority in the year the State incurs an obligation. The "Budget" columns include encumbrance authorization balances carried over from the prior fiscal year because they provided spending authority in the current year. In the GAAP basis statements, encumbrances are not included as expenditures. The effect of this difference is reflected as a reconciling item on the Combined Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General and Special Revenue Funds. The encumbrance of spending authority is recorded as a reservation of fund balance under both bases of accounting.

Capital Leases

For budgetary purposes, capitalizable lease expenditures are recognized when payments are due, rather than upon lease inception as required by GAAP. This difference does not affect fund balance because the "other financing sources" recorded under GAAP at lease inception are not recorded on the statutory/ budgetary basis.

E. Budgetary Overexpenditures

There were no net overexpenditures by General Fund departments. There were, however, the following line-item overexpenditures of State funds incurred during the year, which represent noncompliance with State budget laws (in millions):

General Fund	
Community Health	\$.5
Education	.7
Family Independence Agency	5.6
General Fund Total	<u>\$ 6.8</u>